

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of)	
)	
Connect America Fund)	WC Docket No. 10-90
)	
A National Broadband Plan For Our Future)	GN Docket No. 09-51
)	
Establishing Just And Reasonable Rates For Local Exchange Carriers)	WC Docket No. 07-135
)	
High-Cost Universal Service Support)	WC Docket No. 05-337
)	
Developing An Unified Intercarrier Compensation Regime)	CC Docket No. 01-92
)	
Federal-State Joint Board On Universal Service)	CC Docket No. 96-45
)	
Lifeline And Link-Up)	WC Docket No. 03-109

**COMMENTS OF THE INDEPENDENT TELEPHONE & TELECOMMUNICATIONS
ALLIANCE**

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SUMMARY

ITTA supports the Federal Communications Commission's ("FCC" or "Commission") efforts to develop and implement fundamental reform of the universal service and intercarrier compensation mechanisms. ITTA agrees that the current systems must be updated so that they are compatible with today's telecommunications environment and further the critical goal of deploying broadband services to all Americans. In forging ahead to facilitate the expansion of broadband availability, however, the Commission should not lose sight of the substantial benefits the current universal service and intercarrier compensation policies have engendered. Because independent telephone companies have made good use of the funding from these programs, Americans today enjoy near universal access to voice services, and most rural areas have access to broadband services. Reform should not put these substantial achievements at risk. Continued universal service support and an opportunity to earn a reasonable rate of return are essential for carriers serving rural areas to continue to meet their carrier-of-last-resort ("COLR") obligations, provide current services, and, importantly, expand their networks to those residing in lower-density areas.

As proposed, the interim Connect America Fund ("CAF") proposal risks harming rather than promoting broadband deployment overall by removing necessary support flows to carriers without including an alternative recovery mechanism. Interstate Access Support ("IAS") for price-cap carriers and local switching and safety net support for rate-of-return carriers are important components of independent telephone company revenues. IAS was designed to replace implicit subsidies removed from access charges as part of the CALLS Plan while local switching and safety net support were created to ensure that smaller carriers could earn a reasonable return on investment. The Commission has not shown that these funds are now unnecessary to support the constitutionally-required opportunity to earn a reasonable rate of

return. Without a realistic transition during which carriers are offered other recovery mechanisms, these providers may be unable to continue offering the broadband services already available, and most assuredly will be unable to deploy broadband in additional areas.

Similarly, the Commission proposes to cap interim universal service high-cost support at its level in 2010, with no basis for concluding that this amount would be either sufficient or excessive. Rather than capping high-cost support at an arbitrary number, the Commission should correct problems with the current mechanism by removing incentives for uneconomic investment and eliminating the Identical Support rule. Further, to ensure that COLRs are able to continue providing service in high-cost areas and that current broadband deployment is not jeopardized, the interim universal service mechanism should provide for a right-of-first-refusal for carriers with COLR obligations. Use of the competitive bidding mechanism proposed in the *Notice* would redirect IAS, local switching, and safety net support to those areas where broadband availability could be expanded at the lowest per-unit cost, leaving less support for higher-cost areas.

The competitive bidding mechanism outlined in the *Notice* does not acknowledge the responsibilities and contributions of existing COLR providers. In a once-per-area auction, auction winners would have the incentive to minimize costs by restricting the deployment of new technologies. In a multiple periodic auction scheme, auction winners may underinvest toward the end of the auction term because further support may not be available, leaving the winner with stranded investment. These incentives would affect both providers and investors, driving up capital and, thus, deployment costs.

A properly designed right-of-first-refusal option could mitigate these problems with the competitive bidding mechanism. Support should be distributed based on applicants' financial

and technical abilities to meet COLR obligations, including serving higher-cost areas so that those in lower-density, more rural areas are not left behind. Importantly, a successful right-of-first-refusal must include a reliable cost model that provides sufficient, regular support payments. If the model suffers from the same problems as exist with the current HCPM and establishes theoretical costs that do not reflect real-world conditions, broadband providers will not have sufficient funding to upgrade their networks. The model must include the costs of serving all businesses and homes and accommodate changing network and market conditions.

The Commission should also implement other changes to make the most efficient use of the funding available. The permanent CAF should fund operating expenses (“OPEX”) as well as capital expenditures (“CAPEX”) to make continuing provision of services in high-cost areas attractive to providers and investors. A CAPEX-focused mechanism will not provide the OPEX support the Commission has acknowledged is necessary for serving the highest-cost, most difficult to serve areas. In addition, the CAF should only support one provider in a geographic area, although this principle should be implemented such that it takes into account that competitors without COLR obligations have defined their own service areas in a manner that allows them to serve only the lowest-cost customers in an area.

Further, when evaluating the comparability of broadband prices in rural and urban areas under Section 254, the Commission should recognize the higher costs of deploying in rural areas and that prices may initially be somewhat different in rural areas to allow carriers time to add customers and gain economies of scale. The Commission should ensure that funding is properly targeted to areas of the country that are high cost, rather than continuing to rely on the uneconomic cross-subsidies that are inherent with study-area and state-wide averaging. Receipt of CAF funding should require meeting reasonable build-out requirements tied to available

funding and based on the number of homes passed, not on adoption rates by customers, and should include the ability to partner with other lower-cost providers, such as satellite operators, to fill gaps in service to the hardest-to-reach subscribers.

The intercarrier compensation system is a critical source of revenue for many telephone companies, but must be updated to account for current market conditions. Changes in technology and increases in competition have created arbitrage opportunities that are undermining necessary support and investment incentives. Adoption of a bill-and-keep mechanism is not feasible at this time because it would not allow rural carriers sufficient opportunity to earn a rate of return consistent with their COLR responsibilities and, thus, would undermine existing universal service gains. ITTA proposes instead that the Commission adopt a gradual glide path in which carriers' intrastate access charges (and reciprocal compensation rates for price-cap carriers) would be reduced to interstate levels over three years. At the end of the third year, the unified interstate/intrastate/reciprocal compensation rate would be reduced further to the lesser of the current rate or the carrier's next lower interstate CALLS target by study area for price-cap carriers. Carriers would be allowed to increase subscriber line charges as an alternative recovery mechanism for these lost revenues. At the end of the fourth year, the FCC would reevaluate market conditions to assess what further changes may be necessary.

ITTA agrees that universal service and intercarrier compensation reform are essential to meeting the deployment goals in the National Broadband Plan. However, in bringing broadband to unserved areas, the Commission must be careful not to undermine the mechanisms that have successfully brought broadband to most rural customers and that will be needed to upgrade and expand existing networks.

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**COMMENTS OF THE INDEPENDENT TELEPHONE & TELECOMMUNICATIONS
ALLIANCE**

The Independent Telephone & Telecommunications Alliance (“ITTA”) hereby submits comments with respect to the *Notice* issued in the above-captioned proceedings.¹ ITTA applauds the Federal Communications Commission (“FCC” or “Commission”) for moving toward comprehensive reform of the current universal service and intercarrier compensation programs. However, notwithstanding the indisputable need for reform, the Commission should not lose sight of the enormous achievements the Commission’s existing universal service and intercarrier

¹ *Connect America Fund*, WC Docket No. 10-90, et al., Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, FCC 11-13 (rel. Feb. 9, 2011) (“*Notice*”). The *Notice* requests comments on all issues other than those raised in Section XV by April 18, 2011. 76 Fed. Reg. 11632 (Mar. 2, 2011).

compensation mechanisms have accomplished in bringing voice and broadband services to Americans. Although ITTA recognizes that reforms are necessary to address changes in technology, bring broadband to additional areas, and recognize market competition, the FCC should ensure that today's accomplishments are not lost in the effort to make improvements.

ITTA is an alliance of mid-size telephone companies which collectively serve approximately 19.5 million access lines in 44 states. ITTA members offer subscribers a broad range of high-quality wireline and wireless voice, broadband, and video services. ITTA members serve predominately rural areas with low-population densities, are governed variously by price-cap and rate-of-return regulations, and have, on average, deployed broadband to approximately 85 percent of their respective service areas. In light of its members' varied business plans and strong deployment achievements, ITTA is positioned to offer a balanced view of how to reform comprehensively both the federal Universal Service Fund ("USF") and intercarrier compensation regime.

I. EXISTING UNIVERSAL SERVICE AND INTERCARRIER COMPENSATION MECHANISMS HAVE PROMOTED BROADBAND DEPLOYMENT IN RURAL AREAS.

In the National Broadband Plan, the Commission focused on the changes that are needed to bring broadband to America's unserved areas.² However, the Commission should not forget the success story that current Commission policies have promoted. Americans enjoy near universal access to voice services,³ and most rural areas have access to broadband services in large part because independent telephone companies have made good use of the Commission's

² Federal Communications Commission, Connecting America: The National Broadband Plan at 136-38 (rel. Mar. 2010), *available at* <http://www.broadband.gov/plan/> ("National Broadband Plan").

³ See FCC Ind. Anal. & Tech. Div., Telephone Subscribership in the United States (Data Through March 2010), at 1 (Wir. Comp. Bur., Aug. 2010).

universal service and intercarrier compensation mechanisms to deploy broadband networks. In the Notice, the FCC confirms that “[r]ate-of-return carriers, on the whole, have made significant progress in extending high speed Internet access service in their territories,”⁴ in part through current universal service support. Mid-size telephone companies serving price-cap areas are also successfully providing broadband services throughout much of their territories and have brought broadband to a substantially larger percentage of customers in rural areas than larger carriers. For example, in the order approving the sale of Verizon’s ILEC operations in New Hampshire, Vermont, and Maine to FairPoint, the Commission noted that “Verizon only provides access to broadband to 62% of its current customers in the three-state region, while FairPoint provides 92% of its customers access to a broadband product.”⁵ Moreover, last year the FCC order approving the sale of certain Verizon exchanges to Frontier stated that “Verizon has deployed broadband to only approximately 62 percent of housing units in the transaction market areas” whereas Frontier “has a broadband deployment rate of 92 percent in its existing, less population-dense footprint.”⁶ CenturyLink “has enabled nearly 6 million access lines for broadband – 89 percent of its total access lines” with various speeds of broadband service, while Qwest “has

⁴ Notice, ¶ 170. See also National Broadband Plan at 141.

⁵ *Applications Filed for the Transfer of Certain Spectrum Licenses and Section 214 Authorizations in the States of Maine, New Hampshire, and Vermont from Verizon Communications Inc. and its Subsidiaries to FairPoint Communications, Inc.*, Memorandum Opinion and Order, 23 FCC Rcd 514, ¶ 30 n.106 (2008) (citation omitted).

⁶ *Applications Filed by Frontier Communications Corporation and Verizon Communications Inc. for Assignment or Transfer of Control*, Memorandum Opinion and Order, 25 FCC Rcd 5972, ¶ 50 (2010) (footnotes omitted).

deployed broadband capability to approximately 86 percent of the living units passed in the transaction market areas.”⁷

It is due in significant part to the Commission’s universal service and intercarrier-compensation policies that broadband has been deployed in rural, high-cost areas. In instituting necessary changes, updates, and improvements to the USF and intercarrier compensation mechanisms to bring broadband to unserved areas, the Commission should not inadvertently undermine the progress that has already been made in providing broadband to currently served areas. Many incumbent local exchange carriers (“ILECs”) face competition in urban areas but remain obligated to serve more rural areas “where there are typically too few customers to support a sustainable business.”⁸ Changes that fail to provide sufficient ongoing support for networks already serving rural, high-cost areas risk jeopardizing not only ILEC efforts to expand their networks and broadband service offerings, but also ILECs’ ability to maintain their current networks and broadband services. Therefore, while ITTA applauds the Commission’s efforts to expand broadband access, the FCC should ensure that it does not diminish the reach and quality of broadband already being provided and create new unserved and underserved areas.

A. Current Universal Service Fund Challenges Arise from Changes in the Marketplace that the Current System Has Failed to Recognize, Not the Failure of Carriers Serving Rural Areas To Bring More Robust, Higher-Speed Broadband to Rural Americans.

In both the National Broadband Plan and the *Notice*, the Commission points out the shortcomings of the current universal service program. However, as explained above, carriers currently receiving high-cost universal service support have done a commendable job bringing

⁷ *Applications filed by Qwest Communications International Inc. and CenturyTel, Inc. d/b/a CenturyLink for Consent to Transfer Control*, WC Docket No. 10-110, Memorandum Opinion & Order, FCC 11-47, ¶ 34 (rel. Mar. 18, 2011).

⁸ *Notice*, ¶ 8.

broadband to their service areas and are continuing to invest in their networks both to offer broadband to more customers and to enhance the quality and speed to their current customers. It is changes in market conditions that have made the current support mechanisms anachronistic, not underperformance by carriers serving rural areas or problems with the Commission's original policies.

For example, competition has brought new entrants to more urban, populated areas. The Commission's current universal service mechanism relies on study areas containing both urban and rural areas so that the lower-cost urban areas provide support for higher-cost rural areas. These new entrants, who do not have carrier-of-last-resort ("COLR") obligations, typically win urban customers from incumbent providers, leaving fewer low-cost (*i.e.*, urban) customers to support those served by incumbents in the higher-cost (*i.e.*, rural) areas. The universal service scheme has not been updated to take these changes into account. Indeed, in many ways, the current system exacerbates the problem through the Identical Support rule, which gives new entrants support based on the incumbent's costs. Erosion of these implicit subsidies has led to substantial increases in universal service support outflows, most of which is for competitive carriers.

Today, private investment in communications companies that rely in part on universal service funding has already been undermined because of regulatory uncertainty. The Commission has been considering possible universal service reform for years without action, and this has created doubt about the nature and sufficiency of any support that it will provide in the future.⁹ Uncertainty drives private investment away from the communications industry because

⁹ The FCC has been studying the issue of comprehensive reform of high cost programs for close to ten years. Comprehensive reform was formally initiated by the Commission over three years ago. *See High-Cost Universal Service Support*, WC Docket No. 05-337, 22 FCC Rcd 20477, 20506 (Fed.-St. Jt. Bd. USF, 2007) ("*Comprehensive USF Reform Recommended Decision*").

investors need to know that their dollars have a likelihood of generating at least as good profits as other types of industries. Meeting national broadband availability goals depends on enabling carriers to attract private investment to achieve both broadband deployment and adoption objectives. The Commission can succeed in this effort by reducing uncertainty and quickly creating a stable universal service program that is both sufficient and explicit.

B. Mandatory Rural Broadband Deployment Responsibilities Without Sufficient Connect America Fund (“CAF”) Support Will Undermine Network Investment.

Achievement of universal service goals depends upon the FCC adopting policies that provide sufficient support to meet any mandated broadband requirements. That principle is embodied in Section 254 of the Act.¹⁰ Although broadband service in most geographic areas can be funded in large part through private investment and subscriber revenues, remote areas of the country cannot economically sustain broadband service without subsidies.¹¹ Thus, to meet mandated broadband requirements, it is important that CAF support not be set artificially low. In particular, the Commission cannot impose new broadband deployment goals without providing

See also High-Cost Universal Service Support; Federal-State Joint Board on Universal Service, Notice of Proposed Rulemaking, WC Docket No. 05-337; CC Docket No. 96-45, 23 FCC Rcd 1531 (2008); High-Cost Universal Service Support; Federal-State Joint Board on Universal Service, Notice of Proposed Rulemaking, WC Docket No. 05-337; CC Docket No. 96-45, 23 FCC Rcd 1467 (2008) (“Identical Support Rule NPRM”); High-Cost Universal Service Support; Federal-State Joint Board on Universal Service, Notice of Proposed Rulemaking, WC Docket No. 05-337; CC Docket No. 96-45, 23 FCC 1495 (2008) (“Reverse Auctions NPRM”) (collectively “USF Notices”). These USF Notices were based on the Comprehensive USF Reform Recommended Decision that itself was based on a number of referrals to the Federal-State Joint Board on Universal Service beginning in 2002. The Commission first indicated its intention to take a global look at the operation of the USF high-cost support programs in 2001. Federal-State Joint Board on Universal Service, Fourteenth Report & Order, CC Docket No. 96-45, 16 FCC Rcd 11244, ¶ 169 (2001) (“Rural Task Force Order”).

¹⁰ 47 U.S.C. § 254(b)(5).

¹¹ The National Broadband Plan states that “[i]n some areas, subsidizing all or part of the initial capex [capital expenditure] will allow a service provider to have a sustainable business. Elsewhere, subsidizing initial capex will not be enough; service providers will need support for continuing costs.” National Broadband Plan at 138.

an opportunity to obtain sufficient funding to support such deployment for areas that are uneconomic to serve.

Regulated offerings such as telephone services have always been provided based on a commitment by regulators to allow the service provider a reasonable opportunity to earn a fair return,¹² which has encouraged private investment. Providing sufficient universal service support is a critical component of the Commission's plan to create an environment that will attract billions of dollars in private capital to build out networks that can support faster broadband services than exist today.¹³ Insufficient support levels will signal to investors that any decision to deploy broadband in high-marginal-cost areas is not worth the risk. Thus, the Commission's new system must provide sufficient support to ensure that investment incentives are promoted and not undermined.

C. Intercarrier Compensation Is an Integral Component of the Financial Structure of Many ILECs That Needs To Be Maintained for the Deployment and Maintenance of Broadband-Capable Networks in Rural Areas.

As the National Broadband Plan acknowledges, intercarrier compensation remains a substantial component of many carriers' revenues.¹⁴ The fees charged by ILECs in rural areas have been developed over many years and are a critical part of their cost recovery. Intercarrier compensation, such as access charges, allows incumbents serving high-cost, low-density areas to cover the costs of maintaining and expanding their networks while charging end-user rates comparable to those in urban areas. Without sufficient intercarrier compensation, ILECs' continued ability to provide broadband services at rates similar to those in higher-density, lower-

¹² See *Federal Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591, 600-03 (1944); see also *Policy and Rules Concerning Rates for Dominant Carriers*, Second Report and Order, 5 FCC Rcd 6786, ¶ 127 (1990) ("LEC Price Cap Order").

¹³ National Broadband Plan at 3.

¹⁴ *Id.* at 140.

cost areas will be compromised, potentially undermining the Commission's goals and resulting in conditions inconsistent with Section 254. In replacing the current intercarrier compensation regime, the FCC must establish a sufficient glide path to give carriers the opportunity to adjust their fees and operations to accommodate change without disrupting their ability to serve customers. A measured transition will go far to ensuring that reform efforts do not undermine the progress that has been made to achieve universal broadband deployment.

II. INTERIM CAF DISTRIBUTION MECHANISMS MUST NOT DISRUPT EXISTING SUPPORT FLOWS NEEDED TO MAINTAIN BROADBAND FOR RURAL AMERICA.

As explained above, the current universal service mechanism has allowed many carriers serving rural areas to bring broadband services to substantial portions of their service territories. Precipitous changes could undermine these successes by depriving carriers of funding needed to maintain and expand their networks. The Commission must adopt a reasonable transition mechanism to the new CAF to ensure that predictable and sufficient support continues for existing networks.

A. Preserving the Financial Integrity of Current Broadband Providers is Essential to Maintaining Existing Universal Service Gains.

The *Notice* proposes certain changes for both price-cap and rate-of-return carriers during the interim period before the CAF is fully implemented that could endanger carriers' ability to preserve current universal service gains. These proposals include substantial decreases in support without the opportunity to recover lost funding through other means, thereby failing to provide for a sufficient level of return to attract the private investment the Commission has determined is critical to fulfilling deployment goals. Prior to implementation of any interim measures, the Commission should confirm that any changes to the current system will not

undermine rural carriers' ability to continue to provide service and are consistent with constitutional requirements.

1. IAS should not be phased out until the permanent CAF mechanism is established and implemented.

In the *Notice*, the Commission proposes to phase out Interstate Access Support (“IAS”) abruptly beginning in 2012.¹⁵ Its rationales are that IAS was part of the CALLS Plan, which has lasted longer than intended;¹⁶ parties have not identified particular areas that will no longer have voice service if IAS is eliminated;¹⁷ IAS is not focused on broadband;¹⁸ and those supporting continuation of IAS did not provide data or analysis demonstrating that IAS is still necessary for advancing broadband deployment.¹⁹ As explained below, until new universal service support mechanisms are fully implemented, IAS will remain critical to ensuring the maintenance and expansion of rural broadband networks.

The purpose of IAS was to replace implicit interstate universal service support that was removed from access charges as part of the CALLS Plan for carriers serving lines in areas where they could not recover their permitted revenues from subscriber line charges (“SLCs”).²⁰ The \$650 million initially allocated to IAS was a product of negotiation among the carriers involved and was fixed for five years, at which time the FCC would “make any adjustment to the fund that is necessary to ensure that such funding is sufficient, yet not excessive, to keep rates in high-cost

¹⁵ *Notice*, ¶ 229.

¹⁶ *Id.*, ¶ 233.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*, ¶¶ 232.

²⁰ *Access Charge Reform, et al.*, Sixth Report & Order in CC Docket Nos. 96-262 & 94-1, Report & Order in CC Docket No. 99-249, Eleventh Report & Order in CC Docket No. 96-45, 15 FCC Rcd 12962, ¶¶ 194-95 (2000) (“*CALLS Order*”).

areas affordable and reasonably comparable to rates in areas with greater population density.”²¹

Thus, the *CALLS Order* makes clear that the FCC did not intend for IAS to be terminated after five years; rather, the Commission would determine if the size of the fund needed to be increased or decreased at that time. ITTA believes that any Commission examination of the costs of providing service in rural areas would only confirm that IAS is still needed.

IAS was designed to replace implicit universal service support that was removed from access charges and could not be recovered as part of the SLC. Therefore, the Commission’s assertion that IAS should be eliminated unless carriers can show that a particular geographic area will lose voice service is unreasonable – the purpose of IAS was to ensure carriers could continue to achieve the constitutionally-required rate of return for serving high-cost areas. Likewise, the FCC’s suggestion that it should apply an X-factor to offset the exogenous cost adjustment that would arise from the elimination of IAS²² further undermines existing rate mechanisms without reforming them. If IAS is terminated and carriers cannot make up this loss in revenue through an exogenous cost adjustment, the FCC is implying that IAS funding is no longer necessary without any basis in the record for doing so.

While the *Notice* recognizes that “[c]arriers receiving IAS today are not required to use such funding to deploy broadband-capable networks,” it also acknowledges that IAS “may be a significant source of revenue for carriers that have ongoing broadband deployment plans.”²³ In fact, IAS is distributed on a targeted basis so that it goes to those carriers serving the highest cost wire centers.²⁴ Without such subsidies, there is no business case for serving those areas. It is in

²¹ *Id.*, ¶ 203.

²² *Notice*, ¶ 236.

²³ *Id.*, ¶ 238.

²⁴ 47 C.F.R. § 54.807.

part because of IAS that many high-cost areas have broadband services and high-quality voice networks today. The FCC has already recognized that in rural and high-cost areas, price-cap carriers have not achieved the same broadband penetration as rate-of-return companies.²⁵ This is in large part because these areas are not economic to serve and existing universal service policies do not provide adequate support for such areas. Arbitrarily eliminating IAS will deprive non-rural carriers of the funds employed to maintain and expand broadband offerings in the high-cost and rural areas in their service territories and jeopardize carriers' ability to raise private capital. To avoid undermining the rural broadband gains that have been achieved to date, the Commission should not eliminate IAS until the new CAF mechanism is fully implemented.

2. Rate-of-return mechanisms, such as local switching and safety net support, cannot be eliminated without adequate assurance that support will be replaced with CAF funding.

In the same way the Commission suggests ending IAS support for price-cap carriers, the *Notice* proposes to eliminate local switching support (“LSS”) and the safety net additive for rate-of-return carriers.²⁶ In support of its proposal to eliminate LSS, the Commission focuses on the fact that LSS was designed to support the purchase of circuit switches for smaller carriers, but the soft switches now available are less expensive and easier to scale to smaller operations.²⁷ In addition, the *Notice* argues that although the threshold for LSS is 50,000 lines, some carriers have multiple study areas with fewer than 50,000 lines but in the aggregate are substantially larger.²⁸ Similarly, the Commission proposes to eliminate the “safety net additive,” which is designed to provide sufficient support for rural ILECs that make additional investment above

²⁵ National Broadband Plan at 141.

²⁶ *Notice*, ¶ 186.

²⁷ *Id.*, ¶ 187.

²⁸ *Id.*, ¶ 188.

capped amounts.²⁹ The *Notice* states that the amount of safety net additive support has increased substantially since 2003 and is not targeted in such a manner to ensure that it supports new broadband investment.³⁰

ITTA agrees that both of these mechanisms could be improved. However, what the *Notice* fails to acknowledge is that it is universal service subsidies in combination that have allowed rural carriers to expand broadband throughout their service areas. For example, although the safety net additive increased from \$9.1 million to \$78.9 million between 2003 and 2010, it is during this same period that rural carriers have built out their broadband networks. Although it may be possible to dispute the benefits of payments to individual carriers, there is no doubt that these subsidies in general have financed increased broadband deployment in rural areas. Moreover, although the Commission speculates that these funds are no longer needed, it has not shown that rate-of-return carriers will be able to earn a reasonable rate of return without them. Therefore, until the CAF is fully implemented and providing the funding needed to maintain and expand broadband networks in high-cost areas, the Commission should maintain these important support mechanisms.

3. Constitutional due process implications arise if there is a significant gap between the elimination of existing support and the replacement of that support with CAF funding.

The Commission asks if it has the legal authority to eliminate IAS as part of the transition to new universal service and intercarrier compensation funding mechanisms.³¹ While ITTA agrees that the Commission has the authority to alter or eliminate subsidy programs and that

²⁹ *Id.*, ¶ 185.

³⁰ *Id.*, ¶ 184.

³¹ *Id.*, ¶ 239.

there is no constitutional right to government-subsidized profits,³² the Commission is still bound by the Takings Clause of the U.S. Constitution. Regulated entities are constitutionally required to have the opportunity to earn a reasonable rate of return based on regulated assets and costs.³³

Carrier compensation rates have been set at current levels based on numerous rulemakings and court decisions.³⁴ IAS was developed to replace implicit subsidies that were removed from rates, and LSS and the safety net additive were created to assist in the building of networks by smaller carrier by ensuring that the costs of doing so would not have to be recovered fully from end users. Supreme Court precedent mandates that to change a rate-setting methodology, the Commission must offer a reasoned explanation, weigh the potential public interest impacts, and give the carrier a reasonable opportunity to recover its costs through an alternative associated with regulated services.³⁵ Because the Commission still regulates interstate access rates, it cannot arbitrarily eliminate IAS, LSS, or the safety net additive without determining that these funds are no longer needed or ensuring that the carrier has an opportunity to replace them through other means.

³² *Id.*, ¶ 240.

³³ *See* note 10, *supra*.

³⁴ *See, e.g., LEC Price Cap Order; CALLS Order.*

³⁵ The U.S. Supreme Court has held that a government agency cannot simply abruptly change an historic regulatory scheme by eliminating compensation mechanisms without providing an adequate way to recover prudent investment that was recovered through a state-imposed rate-setting methodology. *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 315 (1989) (“[A] State’s decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions.”). For example, the Commission determined in adopting the CALLS Plan that IAS was necessary to replace implicit subsidies in interstate access rates so that carriers would be able to provide services at affordable rates. *CALLS Order*, ¶ 32.

B. The Size of the Universal Service Fund Is Best Controlled Through Rational Collection and Allocation Policies, Not Through Imposition of Arbitrary Caps.

The Commission proposes to cap the CAF such that all high-cost support will be equal in size to the current high-cost program in 2010, approximately \$4.3 billion.³⁶ However, the *Notice* provides no basis to conclude that this amount is either sufficient or excessive. The National Broadband Plan's estimate that approximately 14 million Americans currently do not have broadband available³⁷ points to a conclusion that additional funding is needed. However, increased universal service contributions raise costs and therefore prices for all consumers³⁸ which could lower broadband adoption rates.³⁹ ITTA urges the Commission to determine the size of the high-cost fund based on the level of support needed to meet the goal of expanding broadband services to all Americans, rather than on the current amount of funding which is based on the cost of deploying and maintaining voice service networks and may not be adequate to support broadband deployment.

If the Commission does determine that caps are necessary, it must ensure that they are implemented in a manner that encourages the efficient use of support. For example, the current program cap on high-cost support encourages a "race to the top," by which carriers investing the most in their networks get the majority of the funding while other carriers, whose investment may be more prudent, are unable to obtain any support because of the fund's cap. ITTA believes that a more equitable system in which support is based on efficient deployment would better target funding.

³⁶ *Notice*, ¶ 414.

³⁷ National Broadband Plan at 136.

³⁸ *Notice*, ¶ 10.

³⁹ National Broadband Plan at 23.

Similarly, establishing an overall cap for all universal service programs would create incentives for those receiving subsidies from particular universal service programs to take actions to prevent losing support from their program because of the cap, regardless of whether such action would otherwise be economically efficient. An overall cap on all universal service programs, while allowing individual programs to fluctuate (such as inflation-adjusted schools and libraries support mechanism or a demand-driven increase in the lifeline program) could eventually produce lower support for high-cost programs violating Section 254's "sufficiency" and "predictability" mandates. Particularly given the fact that the FCC has not yet evaluated the correct amount of "sufficient" support for new broadband rural and high-cost and lifeline support programs, the FCC must first make a rational evaluation of overall funding needs, rather than arbitrarily concluding that current funding levels without such new programs are correct when the new programs are included.

To further ensure that universal service funding is available only where needed to maintain and expand broadband service, the Commission should phase out the Identical Support rule over a five-year period, as proposed in the *Notice*.⁴⁰ ILEC universal service support is based on ILEC expenses and costs, including those to meet COLR obligations. Providing support to competitive carriers, both wireless and wireline, based on ILEC costs does not promote broadband deployment. Competitive carriers are under no obligation to build out networks or provide service in unserved areas. Moreover, new entrants are likely to have taken advantage of the more efficient network components currently available and therefore have lower costs than the ILEC. Providing support to competitive carriers based on the incumbent's costs gives them a revenue windfall with no corresponding COLR obligations. Policymakers have long agreed that

⁴⁰ *Notice*, ¶ 247.

this Identical Support rule leads to an inefficient use of funding and is not in the public interest.⁴¹ The Commission should eliminate this support and ensure that all subsidies are tied to a carrier's actual costs.

C. The Interim CAF Program as Proposed Could Impair Needed Support Flows and Must Include a Right-of-First-Refusal for Carriers with COLR Obligations.

The Commission proposes to eliminate certain high-cost universal service support distribution mechanisms beginning in January 2012 and to distribute the saved funds, at least initially, through an interim CAF program.⁴² Available amounts for the interim CAF would be derived from funds previously distributed as IAS, LSS, the safety net additive, and funds provided to competitive eligible telecommunications carriers ("CETCs"), as well as other proposed changes to the high-cost fund rules.⁴³ Support would be distributed pursuant to a system of competitive bidding that would award funds to those bidders proposing the lowest per-line amount of support necessary to deliver broadband services, until the interim money has been dispersed.⁴⁴ ITTA appreciates the Commission's intended goal to jump start greater broadband availability while developing a permanent distribution mechanism for the CAF. However, ITTA has serious concerns with the proposed interim CAF mechanism.

The diversion of funds for an interim program risks undermining existing support that is currently used to provide broadband services, particularly to rural Americans. Although the FCC's goal of universal broadband is laudable, the Commission must not lose sight of the need for funding to maintain and expand already existing broadband networks. In addition, it is likely

⁴¹ See, e.g., *Comprehensive USF Reform Recommended Decision*, ¶ 27; *Identical Support Rule NPRM*, ¶ 10.

⁴² *Notice*, ¶ 276.

⁴³ *Id.*, ¶ 276.

⁴⁴ *Id.*, ¶ 284.

that development of an interim program could take longer than the Commission anticipates, which would lengthen the time between the elimination of current subsidies and full implementation of the CAF.

The gap between elimination of current funding and resumption of permanent funding would have the most deleterious effect on carriers serving the highest-cost areas. For instance, once LSS is withdrawn from a carrier that was using it to deploy broadband in its rural territory, the carrier could be left without adequate funding for years while a permanent mechanism is being developed. Such a carrier would be unlikely to receive interim funding because of its relatively high per-line costs. Under the Commission's proposed auction mechanism, only carriers with the *lowest per-unit bids* would receive funding.⁴⁵ As a result, funding would be diverted to lower-cost areas in the country, leaving higher-cost carriers unable to continue building out their networks, and further delaying overall broadband deployment. In addition, if for some reason the interim CAF program is delayed or abandoned, the amount of unspent funds which is collected but not distributed would continue to increase, creating a potentially large residual pool, which might form an irresistible source of funding for any number of projects that may or might not be spent on broadband.

As proposed, the interim CAF is focused on CAPEX support, without any provision for operating support ("OPEX") support. Although existing funding sources such as IAS, LSS, and safety net additive support provide funds to support OPEX, the proposals for the interim CAF program would eliminate such OPEX support and replace it with additional CAPEX support. Thus, although the FCC acknowledges the need for OPEX support,⁴⁶ the interim program is

⁴⁵ *Id.*, ¶ 286.

⁴⁶ *Id.*, ¶ 14; National Broadband Plan at 137.

unlikely to provide it, which would put a substantial burden on those rural carriers that have already invested in broadband networks.⁴⁷

A sufficiently funded interim plan is particularly important for areas served by carriers with COLR responsibilities. COLR requirements were developed in the context of voice service regulation to ensure that as many customers as possible could obtain services at reasonable prices. The FCC recognized the importance of the COLR principle in the National Broadband Plan.⁴⁸ To meet COLR responsibilities, ILECs were required to build networks near to where customers reside so that prompt service could be provided to those who request it. The resulting nearly ubiquitous network has redounded to the benefit of broadband customers who receive service over the same network. If current support needed to make service economically viable is diverted from a COLR to a lower-cost-per-unit provider in another area, COLR obligations would be jeopardized. Such diversions would discourage COLRs from investing their own funds in marginal economic areas within their territory, undermining the private investment the Commission is seeking to expand broadband in rural areas.

The interim mechanism may create an incentive to make low bids to build networks in relatively low cost areas to increase the chances of receiving funding. Such an incentive may benefit bidders, but is unlikely to achieve much in the way of bringing broadband to unserved Americans, who in all probability reside in relatively higher cost areas. This poses a substantial risk to program goals.

⁴⁷ The Commission's proposal to place a limit on OPEX support for rate-of-return carriers during the interim, *Notice*, ¶¶ 203-07, risks compounding this methodological error.

⁴⁸ *See, e.g.*, National Broadband Plan at 59 (noting that FCC must consider COLR obligations in transition from circuit-switched networks to IP-based networks); at 137 (stating that revenue gap does not take into account if other provider receives support in areas where current provider has COLR obligations).

Consequently, as discussed in Section III.C., below, the right-of-first-refusal mechanism for incumbent COLR providers must be made available prior to offering any interim CAF funding to other providers. Stated another way, the Commission should delay decreasing current funding that is being used to meet universal service objectives until a right-of-first-refusal mechanism is in place.⁴⁹

D. The USF Contribution Mechanism Should be Expanded To Include All Those Using Broadband-Capable Networks.

In the *Notice*, the Commission attempts to reform the high-cost universal service mechanism without addressing how contributions to this system are assessed.⁵⁰ This is a fundamental error. As noted above, ITTA believes that arbitrary caps on the high-cost fund will undermine the goal of universal broadband deployment. Indeed, the lack of build-out in certain areas implies that additional high-cost funding over and above what is currently available may be needed. However, the Commission has acknowledged that funding universal service increases the cost of broadband and discourages adoption.⁵¹ Therefore, the FCC should consider how the permanent CAF will be funded at the same time as it determines how the funds will be distributed.

There is near unanimity in the telecommunications industry that the contribution factor needs to be moved to a more stable and rational basis.⁵² The universal service contribution

⁴⁹ See Section II.A., *infra*.

⁵⁰ Commission staff has declined to predict when reform of the contribution mechanism will take place, notwithstanding the fact that the FCC's timelines on making broadband reforms scheduled the contribution mechanism NPRM for adoption in the fourth quarter of 2010. See <http://www.broadband.gov/plan/broadband-action-agenda.html> - wcb-usfcontrib-nprm.

⁵¹ *Notice*, ¶ 10.

⁵² For instance, the USF by the Numbers Coalition is composed of virtually every major type of telecommunications industry member. See, e.g., USF by the Numbers Coalition, *The Consumer Benefits of a Numbers-Based Collection Mechanism to Support the Federal Universal Service Fund* (rel. Jan. 30, 2007).

factor was below 6 percent when it was first assessed in the year 2000. With the current contribution factor at 14.9 percent⁵³ (which is slightly lower than the all-time high of 15.5 percent), immediate action is required to mitigate the burden on end users while ensuring continuing support for universal service. The Commission has acknowledged that the current interstate telecommunications service funding base is contracting, even while demand for support is increasing.⁵⁴ It is critical that the contribution base be expanded and stabilized without further delay to ensure sufficient funding will be available to fulfill the Commission's goals.

ITTA urges the Commission to broaden the contribution base so that businesses that rely on the broadband network to provide their services contribute to the support and expansion of that network through universal service mechanisms. At a minimum, all companies providing broadband services should contribute to the USF just as telecommunications service providers do today. In addition, other businesses impose significant costs on broadband networks, necessitating that network providers invest billions to upgrade their networks to meet demand for Internet service, but pay none of its costs. For example, a small telephone company in North Dakota calculated that it cost the company approximately \$30 to stream a movie from Netflix to a residential customer,⁵⁵ but Netflix does not contribute to the universal service fund. Further, Netflix has developed methods of minimizing data demands for Canadian customers, who are subject to monthly caps on total data consumed.⁵⁶ However, because neither businesses nor consumers must pay the costs they impose on broadband networks in this country, neither

⁵³ *Proposed Second Quarter 2011 Universal Service Contribution Factor*, CC Docket No. 96-45, Public Notice, DA 11-473, 1 (Off. Managing Dir., rel. Mar. 10, 2011).

⁵⁴ *See Federal-State Joint Board On Universal Service*, CC Docket No. 96-45, Report & Order and Second Further Notice of Proposed Rulemaking, 17 FCC Rcd 24952, ¶ 3 (2002).

⁵⁵ Bill Myers, "Netflix Growing, Cords Not Being Cut, Researcher Says," *Communications Daily* (Mar. 31, 2011).

⁵⁶ *Id.*

Netflix nor other business have any incentive to use the network more efficiently. Given that the contribution methodology for supporting universal service is interwoven with the distribution needs and adoption incentives for broadband, ITTA urges the Commission to reform the universal service contribution mechanism so that it encourages users to make efficient use of broadband networks and provides adequate, stable funding for future broadband services.

III. THE CAF SHOULD BE CONSTRUCTED TO RETAIN EXISTING ADVANCES IN BROADBAND WHILE ENSURING FINANCIAL STABILITY AND PREDICTABILITY SO THAT CARRIERS CAN CONTINUE BROADBAND DEPLOYMENT.

Although ITTA supports reforming the universal service program to promote ubiquitous voice and broadband services, the challenges to implementing such a reform effort are considerable. As explained above, the transition from voice support to voice and broadband support is particularly difficult because it could cause serious disruptions if funds are diverted from the continuing support needs of rural and high-cost providers of network services. ITTA believes that adoption of the following principles would create a vibrant broadband fund without undermining the important accomplishments that the FCC's universal service program has achieved to date.

A. Eligibility for USF Support Should Be Based on Demonstrated Ability To Meet Service Standards and COLR Responsibilities.

The FCC should define specific requirements for obtaining CAF support. First, applicants should demonstrate that they have the technical ability and financial wherewithal to complete construction in accordance with FCC build-out requirements so that funding is not wasted. Second, it is crucial that CAF recipients be required to provide broadband and voice services throughout a specific geographic territory.⁵⁷ Such a coverage requirement is similar to

⁵⁷ The Commission has previously required an eligible telecommunications carrier to provide service throughout a rural ILEC service territory in order to qualify for universal service support

current voice service COLR obligations which are responsible for universal deployment of voice services throughout the United States. The new broadband COLR would require ubiquitous service throughout a territory, unlike the anti-redlining law imposed on cable TV operators,⁵⁸ which has allowed creation of franchise areas that exclude high-cost customers.⁵⁹ Third, the CAF should take into account that existing voice networks support critical consumer needs such as emergency services,⁶⁰ CALEA,⁶¹ and telecommunications relay services.⁶² These conditions are necessary to ensure that public interest mandates continue to be met.

Once the Commission has begun implementation of the CAF funding process, if the existing ILEC with COLR responsibilities for voice services is not selected to receive CAF funding, it should be immediately freed of any COLR obligation for voice services. Without CAF funding, the COLR would not be receiving the support necessary to fulfill its obligations and thus would no longer have an opportunity to earn a reasonable profit. Due process requires that if the carrier loses the benefit of the original regulatory bargain, its COLR obligations and any pricing and service regulations would need to be eliminated at the same time.⁶³

pursuant to the requirements of 47 U.S.C. § 214(e)(5). If CETCs are allowed to choose their own service areas, they are likely to cherry pick the lowest cost customers rather than serving both higher and lower cost customers.

⁵⁸ See 47 U.S.C. § 541(a)(3).

⁵⁹ Cable TV companies often define franchise areas to exclude the most rural Americans, thereby limiting the ability of cable networks to reach unserved broadband areas. Comments of CenturyLink, WC Docket No. 10-90, at 46-48 (filed July 12, 2010). Wireless carriers have also failed in this regard, even though some of them have become CETCs with the promise to advertise the availability of their services throughout their territory.

⁶⁰ 47 C.F.R. §§ 64.3000, *et seq.*

⁶¹ See, e.g., 47 C.F.R. §§ 1.20000, *et seq.*

⁶² 47 U.S.C. §§ 64.601, *et seq.*

⁶³ See Section III.A., *supra*.

B. Competitive Bidding Is Not the Correct Model to Use in Distributing CAF Funds Because it Does Not Adequately Recognize the Contributions and Responsibilities of a COLR in Providing Service to Rural Americans.

The FCC proposes to use competitive bidding to distribute interim CAF support, and also indicates that this is its preferred distribution model for the permanent CAF.⁶⁴ ITTA does not oppose the use of reverse auctions to determine permanent universal service support levels in unserved, green-field areas. However, ITTA submits that the FCC should conduct auction trials prior to embracing their widespread use for distributing the permanent CAF in unserved areas. Such tests would provide vital data to determine whether auctions will be a useful method for distributing universal service funding.

In COLR-served areas, however, the use of auctions would create substantial problems. The Nation's impressive record of network deployment for voice services, and the adoption rate among users, is the result of a stable regulatory environment. Auctions do not provide this stability and will be unlikely to promote the same level of deployment of broadband networks.

Auction winners will have the incentive to restrict deployment of new technology to minimize costs. This is especially true where auctions are conducted only once per area, and where only CAPEX is funded, as in the interim CAF proposal. Where multiple periodic auctions are contemplated, such as in the permanent CAF program, deliberate underinvestment may emerge toward the end of an auction term, when the supported provider is faced with the prospect of either losing ongoing support and thus stranding investment or transferring assets to a new auction "winner." This risk of stranded investment would affect not only providers, but also investors, whose willingness to support a long-term rural business model would be compromised, driving up the costs of capital and deployment.

⁶⁴ Notice, ¶ 261.

Consumers, too, could suffer unintended consequences with a periodic auction. At the end of the auction winner's term, the supported provider would have little incentive to continue investing in the network and offering high-quality services. The Commission would also need to account for a transition since a new bid winner is unlikely immediately to be able to assume the COLR obligations of which the exiting provider is relieved. Finally, auction cycles may not correlate with investment and depreciation cycles. Investors will naturally prefer a longer investment term, which might well be interrupted by the conduct of a periodic auction. And the development of the auction process must be reconciled with the usual cyclical replacement of plant with different depreciation lives, rather than "all at once," characterized by the Commission as "lumpy investment patterns."⁶⁵

As noted earlier, and as evidenced in the current universal service model, support is not only for initial deployment, but also for maintaining network operations. A CAPEX-only auction would discourage a provider from enhancing its existing network if there is little possibility to recover those expenditures beyond initial deployment.⁶⁶

The auction model identified by the Commission for governing the interim CAF (and possibly the permanent CAF) takes none of these concerns into account. For all these reasons, ITTA has serious doubts that the auction model proposed in the *Notice* would be in the public interest for areas served by COLRs.

⁶⁵ *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers, et al.*, Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, et al., 16 FCC Rcd 19613, ¶ 86 (2001).

⁶⁶ Although problematic in a currently served area, the auction process may work in unserved areas where current broadband deployment cannot be undermined and quick review of the auction winners' deployment success can be monitored.

C. The Right-Of-First-Refusal Option, If Implemented Correctly, Could Recognize and Preserve the Contributions a COLR Makes in Deploying Broadband-Capable Networks to Rural and High-Cost Areas.

The Commission proposes that, if competitive bidding is to be introduced for distribution of the permanent CAF program funding, it should consider adopting a right-of-first-refusal for the incumbent to receive CAF support based on a cost model.⁶⁷ The right-of-first-refusal option could potentially take existing customer needs and COLR responsibilities into account. As ITTA indicated above, it is concerned about use of competitive bidding in situations where a COLR may be displaced by a new provider.⁶⁸ The right-of-first-refusal option appears to provide a one-time preference for the current COLR to preserve the public benefits of its network deployment.⁶⁹

As indicated previously, COLR protections have been highly successful because they have promoted the build-out of a robust network that is also capable of providing broadband services. Offering the COLR sufficient support so that it can preserve and upgrade its current network is less expensive than building a new network from scratch. The cost savings will benefit the CAF by decreasing the amount of support necessary to achieve the targeted level of broadband service. Current subscribers also would benefit from a provider that can continue uninterrupted, high-quality service. The right-of-first-refusal option also provides some constitutional protection to the existing COLR that has not fully recovered the costs of building its network.⁷⁰

⁶⁷ Notice, ¶ 431.

⁶⁸ See Section II.C., *supra*.

⁶⁹ Of course, if the COLR does not exercise its right of first refusal, then the competitive bidding model would be the default option.

⁷⁰ See Section II.A.3., *supra*.

1. Model-based support will succeed if correctly developed to avoid HCPM's pitfalls.

The ability of the right-of-first-refusal option to achieve the stated goals, however, is directly related to how reliable the cost model is that is used to define “sufficient” support levels for voice and broadband services. The Commission should not repeat the mistakes it made with the High Cost Proxy Model (“HCPM”) by creating irregular support payments and using the model to artificially decrease support payments as a simple cost-cutting exercise. The model also must incorporate a realistic view of how rural costs are incurred, avoiding the problems the HCPM creates when attempting to predict support in rural areas.⁷¹

Although a model can be an important tool in determining support amounts, models cannot account for all real-world factors. Applying a model to a rural area can create anomalies that make a model’s general assumptions inaccurate, particular if modeling efforts are drawn from a limited range of inputs. Models require adequate testing, and the outcomes can be only as good as the inputs used.⁷²

The HCPM was the result of “an open, deliberative process in which industry experts, state commissions, staff of the Federal-State Joint Board on Universal Service, and other interested parties provided valuable assistance.”⁷³ Nevertheless, the HCPM has numerous deficiencies. It has been roundly criticized for not adequately modeling the actual networks in

⁷¹ The FCC refused to apply the HCPM to rural company high-cost loop payments. *Rural Task Force Order*, ¶¶ 25-31, 175. The Commission has never revised the model in such a way as to accommodate adequately rural areas and smaller companies.

⁷² As ITTA has stated previously, because the model included in the National Broadband Plan was unavailable for testing, it is impossible to determine if it can adequately calculate necessary support for rural areas, including for a right-of-first-refusal option. Comments of ITTA, GN Docket No. 10-90, 9-10 (July 12, 2010).

⁷³ *Connect America Fund; A National Broadband Plan for Our Future; High-Cost Universal Service Support*, WC Docket No. 10-90, *et al.*, Notice of Inquiry and Notice of Proposed Rulemaking, 25 FCC Rcd 6657, ¶ 6 (2010).

place so that a reasonable base line is available.⁷⁴ If the FCC is going to create a new model for use in distributing broadband support, the model must better estimate existing network costs to ensure there is sufficient support to promote broadband availability goals. If the model establishes a theoretical cost that does not reflect real-world characteristics in particular markets, a broadband provider would be required to upgrade the network without sufficient funds to do so. Such a result would violate Section 254's "sufficiency" requirement, create serious constitutional due process ramifications, and fail to increase broadband availability, undermining the Commission's goals.

The model implementing any right-of-first-refusal option should be based on efficient and reasonable technologies that are robust, scalable, secure, and reliable. The HCPM sought to determine the cost of providing service to all businesses and homes in a geographic region.⁷⁵ In a similar fashion, the network that is being modeled for the CAF should not be limited to bringing service to select customers or institutional locations, but rather should model the costs of building the network in the designated geographic area. As with the HCPM, the CAF model

⁷⁴ See *Federal-State Joint Board on Universal Service*, Order on Remand, Further Notice of Proposed Rulemaking, & Memorandum Opinion & Order, 18 FCC Rcd 22559, ¶ 14 (2003) (denied Qwest and SBC requests to increase non-rural funding); *Id.*, ¶ 27 (denied Vermont petition to increase non-rural support); *Iowa Telecom Petition for Forbearance Under 47 U.S.C. § 160(c) from the Universal Service High-Cost Loop Support Mechanism*, WC Docket No. 05-337, 22 FCC Rcd 15801 (2007); *Hawaiian Telcom, Inc., Petition for Waiver of Sections 54.309 and 54.313(d)(vi) of the Commission's Rules*, WC Docket No. 08-4 (filed Dec. 31, 2007). Although the FCC has not acknowledged these allegations as justification for changing the current USF funding mechanism for non-rural, high-cost loop support, the Commission has never responded to these criticisms. Rather, the FCC has simply concluded that the support issued pursuant to the model is "sufficient" because universal service for voice has been obtained. *High Cost Universal Service Support*, Order on Remand and Memorandum Opinion & Order, WC Docket No. 05-337, 25 FCC Rcd 4072, ¶ 31 (2010). The FCC cannot rely on this post-hoc rationalization for broadband given that ubiquitous broadband deployment has not yet been achieved. It is doubtful that this rationale is true even for voice services given that a number of factors could have resulted in the achievement of universal service for voice, deficiencies in the model notwithstanding.

⁷⁵ *Federal-State Joint Board on Universal Service*, First Report & Order, 12 FCC Rcd 8776, ¶ 250 (1997) ("USF First Report & Order").

should include a reasonable allocation of joint and common costs to supported services and an ability to modify critical assumptions and to de-average support calculations to granular geographic levels.⁷⁶ In addition, the Commission must recognize that many price-cap carriers currently do not receive adequate support for the voice networks they have been required to deploy and which provide the platform for further broadband deployment. Therefore, the Commission must acknowledge that current support levels may not be a reasonable guide for future support levels.

The CAF model must account for the fact that in certain high-cost areas today, voice and broadband services are provided solely because of external assistance, such as through the voice-only universal service system. Such support needs to be continued if the same or more robust broadband is to be provided in these areas. The incremental modeling that has been completed to date assumes, without justification, that no further support is necessary where networks today provide voice and broadband.⁷⁷ Such assumptions are erroneous and need to be corrected in order to meet the “sufficiency” mandate of Section 254. In addition, the model must accommodate changing network cost characteristics, such as declining access lines for wireline carriers, which leaves the carrier with fewer customers to support the existing, relatively fixed costs of the network. Such declines can and do make previously profitable areas uneconomic to serve. These types of situations must also be supported under the CAF.

Ultimately, the success of any model depends on whether its results match actual costs. ITTA submits that if the CAF is expected to replace current high-cost support mechanisms, the

⁷⁶ *Id.*

⁷⁷ Federal Communications Commission, Broadband Assessment Model, at 6 (provided by CostQuest Associates, rel. Mar. 2010), *available at* [http://download.broadband.gov/plan/fcc-omnibus-broadband-initiative-\(obi\)-working-reports-series-technical-paper-broadband-assessment-model.pdf](http://download.broadband.gov/plan/fcc-omnibus-broadband-initiative-(obi)-working-reports-series-technical-paper-broadband-assessment-model.pdf) (“Broadband Assessment Model”).

FCC must include the total costs of existing networks in order to predict accurately the incremental costs associated with upgrading those networks to provide broadband at the mandated speed and expanding the existing network to unserved customers. Without considering actual costs, the Commission is not accurately defining the incremental costs of bringing broadband at the mandated speeds to an area.

2. Modeling or distribution methodologies that are based on net revenues will not lead to sufficient and predictable support.

The FCC asks whether it should base its distribution under a model on a net-revenues approach.⁷⁸ ITTA submits that a net-revenues approach entails substantial risks. Inasmuch as support levels must be sufficient to motivate investment, reliance upon uncertain revenue streams injects doubt. Additionally, identifying revenues derived solely from incremental broadband investment contemplates a complicated, likely infeasible, process. Moreover, the National Broadband Plan makes the unsubstantiated assumption that rural adoption rates will be similar to urban adoption rates when demographics are similar.⁷⁹ Such threshold matters must be resolved before a thorough analysis can be completed.

An accurate model that develops costs for supported services should only take into account the expected revenue from the supported broadband and voice services, not from other services provided over the network. Offering both broadband services at the mandated speed and voice services comprises the obligation associated with universal service support. Because no other services are part of the obligation, including them would distort the incentives and risks of providing broadband. Further, the ability to offer other services on a broadband-capable line

⁷⁸ Notice, ¶ 433.

⁷⁹ Omnibus Broadband Initiative, Federal Communications Commission, Broadband Availability Gap, OBI Technical Paper No. 1, at 42 (Apr. 2010), *available at* <http://download.broadband.gov/plan/the-broadband-availability-gap-obi-technical-paper-no-1.pdf> (“Broadband Availability Gap”).

will vary significantly from market to market. Such deployment depends on considerations that go far beyond a particular geographic area that would be targeted to deploy broadband. The Commission has never before mandated that carriers deploy multiple services over a USF-supported network.⁸⁰

D. Limits on the Number of Supported Providers Should Apply in All Geographic Areas.

The CAF should only support a single provider for both broadband and voice in a geographic area and eliminate duplicative USF support.⁸¹ Support for multiple providers is a waste of limited public resources and should not be used to build duplicate networks.

The one-provider principle, however, does not mean that the Commission should conclude that CAF support is unnecessary where a second facilities-based provider serves only a part of the supported provider's territory.⁸² Many of the nation's urban and more densely populated markets are dominated by intermodal competition where competitors have the freedom to pick and choose where they will provide service, often opting to serve profitable areas while ignoring higher-cost locations.⁸³ Removing support based on the existence of competition in only part of a geographic area would harm the remaining customers that are served only by the supported ILEC. Without the support that made the initial investment

⁸⁰ To include other services in the analysis, the Commission would have to determine an affordable rate for each of those services, which would add further complications.

⁸¹ National Broadband Plan at 145.

⁸² NCTA, for instance, proposes that USF be eliminated for all current recipients when another facilities-based provider serves 75 percent of the households in the recipient's market. National Cable & Telecommunications Association Petition for Rulemaking, GN Docket No. 09-51, WC Docket No. 05-337, CC Docket No. 96-45, at 5 (filed Nov. 5, 2009). The Commission should also reject proposals to eliminate support once there is deregulation of ILEC retail rates in a market. *See, e.g., id.*; Comments of Sprint Nextel, Inc., WC Docket No. 05-337, at 24-25 (Nov. 26, 2008) (retail rate deregulation should justify elimination of USF).

⁸³ The exception to the one-provider-per-area principle would be for mobile services. Comments of ITTA, WT Docket No. 10-208, 2 (filed Dec. 16, 2010) ("ITTA Mobility Fund Comments").

feasible, the ILEC could eventually be forced to cease providing service to the remaining customers.

E. Under the CAF, Prices for Rural Broadband Should Be Reasonably Comparable to Prices in Urban Areas.

According to Section 254 of the Act, the price for broadband in rural areas should be reasonably comparable to the price of such services in urban areas. Section 254 provides that:

Consumers in all regions of the Nation . . . should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.⁸⁴

The Commission should recognize, however, that progress in providing a targeted level of broadband services in rural areas will take time to accomplish because of the expense and challenges associated with deploying facilities in rural areas. Further, prices for services may initially be different than in urban areas because of the enormous start-up costs involved. ITTA therefore urges the Commission to be flexible in its evaluation of comparability to allow this initial ramp-up period to pass and the carrier to gain scale and reduce ongoing costs. A reasonable period of time after full deployment of facilities, the Commission's comparability evaluation will more accurately assess whether the program has met Section 254's universal service goals. Because broadband will be a new service in the geographic territory, the marketplace will serve as a constraining factor on unreasonable pricing. Therefore, although a benchmark price would be appropriate in evaluating the level of CAF support,⁸⁵ the FCC should not regulate the price of broadband services themselves.

⁸⁴ 47 U.S.C. § 254(b)(3).

⁸⁵ See Section III.I., *infra*.

F. The CAF Should Support High-Cost Geographic Areas, Not Large Areas Including Low- and High-Cost Areas.

1. The CAF should provide support on a targeted basis to the rural and high cost portions of a geographic area.

Selection of the geographic area that forms the basis for CAF support is one of the most important issues to be resolved in this proceeding. Selecting an area that is too large will inevitably include locations which are not high cost and thus not in need of support. Selection of too small an area will decrease incentives for new entrants. In addition, existing networks that are the most likely to be able to provide broadband at the mandated speed serve different and perhaps overlapping areas.

The CAF should also be structured to avoid the most serious defect of the non-rural, high-cost loop mechanism – failure to provide sufficient support for the high-cost parts of large study areas. Averaging of universal service funding over study areas, as well as the state-wide averaging used to distribute non-rural, high-cost loop support, has led to lower broadband penetration in the rural areas served by non-rural carriers than in rural areas served by rural carriers. The National Broadband Plan recognized this critical problem, although it did not offer a solution.⁸⁶

Study-area averaging did not cause these problems in a monopoly environment. Such averaging and other implicit funding mechanisms funded COLR networks in uneconomic high-cost areas. Large study areas, however, often mask the significant differences in costs among included wire centers. The effect of study area averaging is to deprive wire centers of funding for which they would qualify if they had stand-alone operations. This policy allows lower-cost urban areas to subsidize more costly rural areas, but prevents carriers from competing in the

⁸⁶ National Broadband Plan at 141.

urban areas based on actual costs. Such an anticompetitive cross-subsidy cannot be sustained. If ubiquitous broadband availability is to be attained in a competitive environment, broadband support mechanisms must be designed differently than those in place today, which were developed in a single provider environment.

2. Wire centers should form the basis of support distribution where existing providers with COLR responsibilities exist.

The *Notice* proposes to identify unserved areas by census block, the smallest geographic unit by which the Census Bureau tabulates data.⁸⁷ A census block approach may be useful for evaluating green-field areas where no service has been provided previously.⁸⁸ However, where ILEC wireline operations already exist, the census block metric is an unwise choice. The wireline environment should be evaluated using wire centers to ensure that targeted support conforms to geographic patterns that match the parameters of networks as they have been deployed.

Because wire centers serve existing communities in a geographic area, a competing broadband provider's market analysis would likely lead to a decision to build a network in the same area. In addition, because COLR mandates were created in a wire center environment, the orderly transition to broadband COLR responsibilities would contemplate the transfer of those responsibilities to the entire wire center. Finally, existing wireline broadband providers are the most likely providers of broadband services to uneconomic rural areas.

Although there are differences in the service areas of potential broadband competitors, establishing an area for support based on census blocks, which does not correspond to any existing network, is inefficient for current providers. Discounting existing networks will require

⁸⁷ *Notice*, ¶ 290.

⁸⁸ ITTA Mobility Fund Comments at 6.

support to be based on construction of new networks which increases the amount of CAF support for a particular area.⁸⁹ Thus, consideration of existing network footprints would make the CAF more efficient and more quickly meet the Commission's broadband goals.

G. The CAF Should Adopt Reasonable Build-out Requirements.

CAF support should be provided solely to a carrier that primarily deploys services over its own network, rather than based on resale or use of ILEC wholesale services. This requirement is fully consistent with existing high-cost universal service distribution policy limiting ETC status to network-based operators.⁹⁰ Awarding support to a non-facilities-based provider distorts investment incentives. The underlying wholesale provider would not be motivated to invest because it could not control and expand its network, and the reseller would not be investing at all, since it is only marketing the service it purchases at wholesale. The National Broadband Plan rightfully recognizes that federal policies must encourage private investors to build out networks to provide broadband service.⁹¹ This investment will only occur if CAF recipients are required to build their own networks.

1. CAF recipients should meet build-out requirements based on the percentage of homes passed, not on actual subscriptions.

The FCC staff recognizes that providing broadband to 100 percent of the households in a geographic territory is extraordinarily expensive and has modified its proposals to take this into account.⁹² The build-out requirements should allow a CAF recipient to meet a 100 percent deployment goal by partnering with another provider that can serve the most-difficult-to-serve

⁸⁹ Evaluating the geographic scope of American Recovery and Reinvestment Act applications has been one of the most controversial aspects of the broadband stimulus funding program. *See, e.g.,* Comments of Organization for the Protection and Advancement of Small Telephone Companies, Docket No. 0907141137-91375-05, RUS/NTIA, at 6 (filed Nov. 30, 2009).

⁹⁰ *USF First Report & Order*, ¶ 150.

⁹¹ National Broadband Plan at 5.

⁹² Broadband Availability Gap at 5-8.

customers in a less expensive manner.⁹³ The Commission should be practical in meeting its goals, recognizing that some homes are located in geographic areas that are extremely costly to serve. A customer's decision to locate in these remote areas should not form the basis of unreasonable support funding when there is a cheaper alternative available. Likewise, the Commission should be flexible on the speed of the broadband service which can be provided through the partner's technology during the deployment schedule.⁹⁴ This will permit the partner, such as a satellite service provider, to upgrade its network to offer greater speeds over several years.⁹⁵

The FCC's build-out requirement should be satisfied when a CAF recipient builds or upgrades its network to make broadband available to the appropriate percentage of households. The FCC should not require that a certain percentage of households actually purchase service in order to meet the build-out requirements. Carriers have little control over actual subscribership rates, and consumers do not subscribe to broadband services for a variety of reasons that have nothing to do with the nature or quality of the service itself.⁹⁶ The Commission should instead rely on its broadband adoption efforts to increase subscribership, which ITTA supports.

⁹³ Notice, ¶¶ 98, 132.

⁹⁴ Achievement of minimum speed requirements should be based on average speed capabilities of the network, rather than actual speed rates detected at end user premises because the actual speeds consumers experience are affected by a variety of factors, such as user equipment, including computers, WiFi devices, and other home connections, as well as software used, such as browsers, and web factors such as overall usage levels and web site performance characteristics. *See, e.g., Broadband Performance*, OBI Technical Paper No. 4, 12-13 (Omnibus Broadband Initiative, Aug. 2010), *available at* http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db0813/DOC-300902A1.pdf.

⁹⁵ Comments of Viasat, Inc. & Wildblue Communications, Inc., WC Docket No. 10-90, 4 (filed July 12, 2010); Comments of Hughes Network Systems, LLC, WC Docket No. 10-90, 8 (filed July 12, 2010).

⁹⁶ National Broadband Plan at 168-85.

2. Deployment requirements should be tied to available funding, with payments to be made in phases as construction milestones are met.

As a condition of receiving permanent CAF support, it is reasonable for the Commission to require deployment within certain time frames. Such time frames must be sufficient to make phased upgrades to existing networks, or to expand network coverage to unserved customers. Importantly, however, any deployment requirements must be tied to the amount of CAF funding available for distribution. Requiring providers to meet a deployment schedule without concrete assurances that sufficient funding will be available increases the business risk associated. This increased risk would undermine the private investment needed to supplement CAF support, driving up the costs of providing broadband. In addition, the timing for the distribution of specific amounts of funding can critically affect the speed with which deployment can be accomplished.

ITTA supports the FCC proposal to make progress payments periodically during the course of deployment after a specified level of service has been achieved.⁹⁷ Such interim payments are akin to the method used for funding any construction effort. This tried-and-true measure will promote swift broadband deployment and the wise use of public resources.

ITTA also notes that if the FCC makes CAF support payments after a recipient incurs costs in deploying broadband, the risk that a recipient will not fulfill program requirements is substantially reduced. The existing USF high-cost program for rate-of-return ILECs requires that costs be incurred prior to making support payments.⁹⁸ Although the risk of support loss has not been a problem for ILECs who have years of experience fulfilling their COLR obligations and deploying advanced services, such risks would be greater with new, inexperienced support

⁹⁷ Notice, ¶ 361.

⁹⁸ 47 C.F.R. §§ 36.601, *et seq.*

recipients. Utilizing a post-deployment payment system would preserve CAF funds if, for example, a carrier files for bankruptcy in the middle of a project because the carrier would already have built the network for which it received support.

H. The CAF Should Compensate Carriers for OPEX in Areas that Are Not Economically Sustainable Absent Support.

The Commission recognizes that a certain level of OPEX support must be provided in areas that are otherwise uneconomic to serve.⁹⁹ The cost of providing broadband and voice services in rural America is in large part a function of ongoing OPEX, such as maintenance, repair, and customer service, and a large portion of these costs are relatively fixed and higher than in urban areas. For instance, repair costs per housing unit are often higher in rural areas because of long travel times, the length of the plant that must be inspected and maintained, and the need to locate offices and repair personnel in reasonable proximity to the delivered services. These high relatively fixed costs can only be spread over a limited number of customers in sparsely populated communities and are therefore higher on a per-subscriber basis than in urban areas.¹⁰⁰ If prices of broadband services are not high enough to recoup these costs, then additional support is necessary to “ensure that all people of the United States have access to broadband capability”¹⁰¹

⁹⁹ Notice, ¶¶ 203-04.

¹⁰⁰ The Commission has recognized the much higher ongoing operational costs that some carriers incur. National Broadband Plan at 137, Exhibit 8-B; Broadband Availability Gap at 6, Exhibit 1-B.

¹⁰¹ American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115, § 6001(k)(2) (2009).

In addition, support provided for OPEX should be adjusted for the fact that the amount is likely to be taxable.¹⁰² Universal service fund distributions are currently taxed by the Internal Revenue Service (“IRS”) as income.¹⁰³ Although the industry has regularly argued that these cost-recovery funds should be treated as contributions to capital, and taxed as any capital asset, these efforts have been unsuccessful to date. This policy of taxing support funds strips away a large percentage of the distributions intended to advance universal service and turns over these funds to general government revenues. This tax effect should be taken into account when awarding OPEX support.

I. The CAF Distributions Should Be Based on Costs, Including a Reasonable Benchmark of Local and Broadband Rates.

CAF support should be based on the costs of providing broadband service at the required speed, whether actual costs or model-based costs are used. ITTA submits that any formula used to distribute support should include a benchmark that establishes the reasonable revenues expected from providing voice and broadband services. The use of benchmarks has been proposed in the past.¹⁰⁴ Any benchmark should be reasonably comparable to urban area pricing, and not so high as to undermine the sufficiency of support for providing service in rural and high cost areas.

It is, of course, reasonable to require CAF recipients to account for the expected revenues from supported services. The Commission should incorporate a support offset based on an estimate of broadband revenues, adjusted for the present value of any expected ramp-up in

¹⁰² The National Broadband Plan recognizes this fact, but assumes no need to adjust CAF support because much of the support would be for capital costs, which would not be taxable. National Broadband Plan at 146.

¹⁰³ *United States v. Coastal Utils., Inc.*, 483 F. Supp. 2d 1232, *aff’d*, 514 F.3d 1184 (11th Cir. 2008).

¹⁰⁴ *See, e.g.*, Comments of CenturyLink on NBP Public Notice # 19 (Role of USF and Inter-carrier Compensation), GN Docket No. 09-47, *et. al.*, at 39-40 (filed Dec. 7, 2009).

broadband adoption rates and pricing. Such initial pricing and adoption rates should be carefully considered based on the experience of carriers in deploying broadband for the first time in other rural markets.¹⁰⁵ The FCC should recognize that pricing will often occur for services in a discounted bundle, which will decrease the relative amount of revenue per service included in the bundle.¹⁰⁶ Because the lower pricing will benefit subscribers and increase adoption rates, the FCC's disbursement policies should take into account such lowered pricing.

IV. INTERCARRIER COMPENSATION REFORM SHOULD BE ACCOMPLISHED THROUGH MEASURED STEPS THAT ALLOW CARRIERS SUFFICIENT TIME TO REPLACE LOST REVENUES.

ITTA supports the Commission's conclusion that the intercarrier compensation system requires reform¹⁰⁷ However, as the Commission has acknowledged, intercarrier compensation is a critical revenue component for many telephone companies. Because of this, it is premature for the Commission to determine that such charges can be completely eliminated while preserving a fair rate of return for regulated carriers. Rather, the Commission should adopt ITTA's plan for a measured reduction in interstate and intrastate access charges while ensuring that carriers have an opportunity to recover lost revenues through other mechanisms.

The Commission should focus on five principles in fashioning intercarrier compensation reform. First, it should reduce arbitrage by moving toward a system which requires the payment of equal charges for equal units of traffic. Second, the FCC should stabilize intercarrier

¹⁰⁵ Urban pricing and adoption rates will differ based on market and demographic characteristics, such as the existence of competition, average age of households, average income levels, and other factors. The Broadband Availability Gap indicates that it takes such demographic factors into account, but given the lack of transparency in the model, it is not possible to evaluate whether such inclusion would be accurate. Broadband Availability Gap at 45.

¹⁰⁶ The FCC recognizes that sales of products in bundles will affect the level of revenues to be projected. Broadband Availability Gap at 49. It is unknown whether the assumptions about bundled pricing are realistic because the data relied on by the Commission were not made publicly available.

¹⁰⁷ Notice, ¶ 508.

compensation and provide for a gradual glide path to allow carriers to make operational and financial accommodations to such changes. Third, the FCC should recognize that all users of the network should pay their fair share of the costs of the network. Fourth, the FCC should not establish an artificial intercarrier compensation rate to provide an incentive for carriers to replace existing network infrastructure with a particular type of technology. Investment decisions should be based on financial considerations, not on a government-imposed idea of what network makes sense. Fifth, the Commission should ensure that customers are protected by mandating only a gradual increase in consumer prices, as warranted.

A. Comprehensive Intercarrier Compensation Reform Should Not Result in a Mandatory Bill-And-Keep Environment, Either Directly or De Facto, Such As Through Imposition of a Unified Switched Access Rate That is Near Zero.

The *Notice* requests comment on the methodology for reforming intercarrier compensation, including specifically the merits of a bill-and-keep methodology for long-term intercarrier compensation reform.¹⁰⁸ Given current market structure and intercarrier compensation revenues, a mandatory bill-and-keep mechanism, or a unified switched access rate that is essentially zero, is not feasible at this time. The National Broadband Plan acknowledges that some carriers serving rural areas may receive 60 percent or more of their regulated revenues from universal service and intercarrier compensation.¹⁰⁹ For carriers to continue their successful efforts to provide broadband services in high-cost areas, it is essential that they have predictable and sufficient support, which is guaranteed in Section 254 of the Act.

A bill-and-keep system requires carriers to “recover [access] costs from their own end users.”¹¹⁰ However, in a high-cost area, forcing end-users to bear the full costs of the network

¹⁰⁸ *Id.*, ¶ 530.

¹⁰⁹ National Broadband Plan at 140.

¹¹⁰ *Notice*, ¶ 530.

would result in substantial increases in rates, which would in turn reduce broadband adoption and hence threaten universal service. The Commission posits that CAF support could be used to make up for revenues lost due to implementation of bill-and-keep. However, the Commission's desire to constrain any increases in the size of the CAF and to target CAF funds to unserved areas make it unlikely that there would be sufficient funding to replace lost intercarrier compensation revenues. ILECs have never been guaranteed a certain level of revenues or profits. However, the Constitution requires that regulated entities be given a reasonable opportunity to recover prudent investment.¹¹¹ Rural carriers' investment in broadband services is not only prudent, it is critical to ensuring that rural areas are not "left behind"¹¹² and are able to take advantage of the same opportunities as those in urban areas.

Moreover, moving to a bill-and-keep mechanism would introduce new arbitrage opportunities. In a bill-and-keep environment, providers do not have to compensate the carriers that terminate their traffic so they have an incentive to displace as much of the cost as possible on the terminating carrier. The likely result of implementing bill-and-keep would be a substantial increase in traffic sent to ILEC tandems because this would be least expensive for originating providers. Such increases in tandem traffic would require expensive increases in network capacity for ILECs and undermine the transiting compensation mechanism. Thus, without other regulatory changes, a bill-and-keep scheme would increase the overall costs of terminating traffic for ILECs.

Although elimination of intercarrier compensation is not possible at this time without compromising universal service gains, access charges can be reduced in accordance with a gradual glide path, as outlined in the plan below. The FCC should implement reform in a

¹¹¹ See Section I.B., *supra*.

¹¹² National Broadband Plan at 167.

manner that allows carriers to recover their costs and obtain capital so that they can keep investing and expanding their networks, as it has done in the past. To do this, the FCC must adopt a mechanism that is specific, and preserves the financial integrity of network providers.

When the Commission has revised a rate setting mechanism, but has not determined that carriers are earning an excessive rate of return, it has allowed for decreases in revenues from one source to be offset with corresponding increases in another area. For example, when the Commission first required certain ILECs to convert to price caps, it ordered them to readjust their rates on a revenue neutral basis in order to begin price caps.¹¹³ Similarly, when the CALLS Plan was adopted, the Commission created IAS to make up for revenues lost to decreases in access charges that could not be recovered through increased SLCs.¹¹⁴ Arbitrarily reducing ILEC revenues through lower access rates without a finding that rural carriers will still be able to continue earning a reasonable rate of return is inconsistent with Commission precedent.

The Commission also asks about the use of flat-rated intercarrier charges as a replacement for per-minute access charges.¹¹⁵ As with bill-and-keep, ITTA believes that it is premature to consider flat-rated charges. At this time, it is unclear how a flat-rated mechanism would work and how it could be implemented in a mixed circuit-switched and IP network environment. Therefore, attempting to use flat-rated charges at this time is unwise.

B. The FCC Should Adopt ITTA's Plan To Reduce Access Charges and Create an Alternative Recovery Mechanism.

The Commission asks for alternative approaches to long-term reform of intercarrier compensation. ITTA has for several years advocated a balanced approach to reducing access charges. ITTA continues to believe that the Commission should adopt this approach and

¹¹³ *LEC Price Cap Order*, ¶ 230.

¹¹⁴ See Section II.A.1., *supra*.

¹¹⁵ *Notice*, ¶ 531.

reevaluate how to proceed in four years, after the plan is fully implemented. ITTA's plan would reduce access charges immediately, allow carriers to maintain affordable end-user rates, and maintain sufficient revenue so that rural carriers can continue to invest in their networks.

A fair and measured approach is required so that all industry participants and end users can adjust to these significant changes. Unifying intrastate and interstate access charges is a necessary first step to bring charges more in line with costs and remove arbitrage opportunities. Therefore, ITTA proposes that a price-cap carrier's intrastate access rates be unified to its CALLS target rate in equal increments over three years by study area. If the local reciprocal compensation rate is above the CALLS rate, it should also be reduced to the CALLS level during the same three-year period. Rate-of-return carriers should be required to unify intrastate and interstate access rates at the interstate level. At the end of the third year, the unified interstate/intrastate/reciprocal compensation rate would be reduced to the less of the current rate or the carrier's next lower interstate CALLS target by study area. For example, if a study area's current CALLS target is \$0.0095, then it would move to \$0.0065 in year 4. If the current CALLS target is \$0.0055, the rate would remain at this level. Because all traffic, whether TDM or interconnected VoIP, requires the same resources for termination, all types of traffic would be subject to these same rates.

Because of the importance of intercarrier compensation revenues to rural carriers, the Commission asks for comment on how to establish an alternative recovery mechanism to replace revenue to declining access charges.¹¹⁶ Allowing carriers serving rural areas an opportunity to recover lost revenues would not only ensure that reform is accomplished in a manner consistent

¹¹⁶ *Id.*, ¶ 559.

with constitutional requirements, but would also give carriers the ability to continue to build and maintain the networks that are currently providing broadband to many rural customers.

ITTA proposes that for the first three years of reductions, the FCC make available to all price-cap carriers the opportunity to recover an amount equal to the annual revenue lost due to intrastate access and reciprocal compensation reductions, adjusted annually to reflect access line counts on December 31 of the preceding year. In the fourth year, carriers should be allowed to recover 50 percent of the total reduction attributed to the lowest CALLS-targeted reductions, plus 100 percent of the cumulative total from the first three years. These amounts should be recovered through increased SLCs phased in at \$0.50 per year for residential lines during the first three years. The SLC for business lines would be phased in at \$0.75 per year in the first two years and then \$0.80 in the third year.

At the end of the fourth year, the Commission should review market conditions, including the financial integrity of carriers subject to COLR obligations and the rate of broadband deployment by carriers serving rural areas, and then determine a further plan for reform.

V. CONCLUSION

ITTA supports the FCC's efforts to reform universal service and intercarrier compensation in the manner specified in the preceding comments.

Respectfully submitted,

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